Tax Breaks for Redoing Historic Buildings

by Aimée L. Morner

For investors seeking shelter, old run-down buildings may be just the thing. According to Robert Stanger, editor of the *Stanger Report* on tax-sheltered investments, real-estate deals in general and so-called historic rehabs in particular "are the tax shelters that got the biggest boost from ERTA." That's the Economic Recovery Tax Act of 1981, which has provisions that are encouraging people to create faithful restorations of some real historic treasures.

The tax benefits apply to money spent rehabilitating historic buildings after December 31, 1981. Since the law was passed last August, a flurry of limited partnerships have been set up to take advantage of it. The earliest were formed by small developers or local syndicators and were hard to find. But lately some have been sold by big brokerage firms—including Bache, Paine Webber, Shearson/American Express, and Butcher & Singer—which earn commissions of 7% to 10%.

Not surprisingly, a lot of the historic rehabs are in places like Charleston, Savannah, Baltimore, Philadelphia, and Boston. Most of the money raised is going into redoing hotels and industrial buildings—abandoned factories, warehouses, and textile mills—to convert them into offices and retail stores. Some partnerships are financing the conversion of old town houses into apartments. To get the new tax breaks, the building must be a "certified historic structure," meaning it must be so designated by the National Park Service of the Department of the Interior.

Going public

Many of the partnerships have been small, raising only a few million dollars in equity. These are usually private—not registered with the Securities and Exchange Commission—and require a minimum investment of $100,000 to $150,000 in cash over three to five years. Private partnerships usually invest in only one property, because SEC rules limit the number of investors to around 35. Lately a few deals with two or more properties and lower minimums are being registered with the SEC to tap a larger pool of investors.

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The first public offering that will benefit from the new law was made last fall by Foster & Marshall, a Seattle brokerage firm recently bought by Shearson/American Express. The partnership, called Cherry Street Properties Ltd., raised $11 million, at a minimum of $5,000 per investor. Cherry Street is creating modern office space from two early-20th-century landmarks in Seattle: the Alaska Building, once the tallest office building in the Northwest, and the Arctic Building, home of the Arctic Club for civic-minded men (see photo).

To the accountants' steely eyes, the beauty of historic rehab projects is in the investment tax credit—at 25%, the highest you can get on anything. True, the credit is based on the cost of the rehabilitation, not including the cost of acquiring the building, but typically the overhauling accounts for 80% to 90% of the total cost. The credit applies to both residential and commercial structures, but investors cannot get it for buildings they will live in. (Rehabs of nonresidential buildings that are not certifiably historic but are more than 30 years old can get an investment tax credit of 15% or 20%, depending on their age.) Investors get the tax credit when the rehabilitation is completed, usually the second year.

ERTA also changed the rules for depreciation. Under the old law investors could take either accelerated depreciation or a 10% investment tax credit—but not both. Now they must take straight-line depreciation, but they can take it in bigger annual chunks. ERTA assigns all buildings a 15-year life, down from as long as 50 years. What's more, in historic rehabs—unlike all other real-estate deals—the cost of the project is not reduced by the tax credit for the purpose of figuring depreciation.

The greater the leverage, the bigger the tax breaks because borrowings add to the size of the projects. As real-estate deals go, these are leveraged modestly. Only about half to three-quarters of the project's costs are typically financed by borrowing, partly because money is hard to come by these

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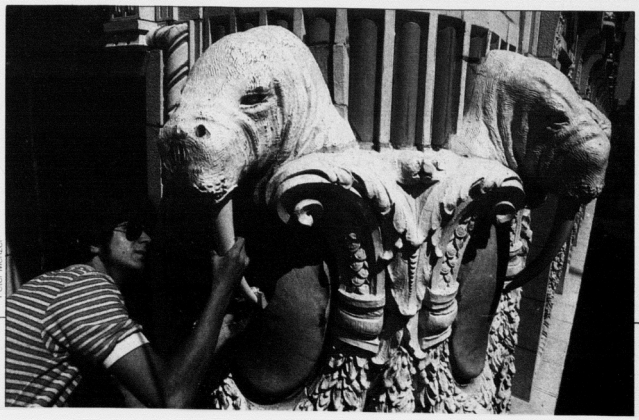
An Untaxing Tusk Task

These walrus heads and 25 others like them adorn the historic nine-story Arctic Building, being rehabilitated in Seattle. Many of these critters lost their tusks during a 1949 earthquake. So that the partnership doing the rehabilitation can get an investment tax credit of 25%, the new tusks were made of a material—cast epoxy—that closely resembles the original—molded terra-cotta.



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